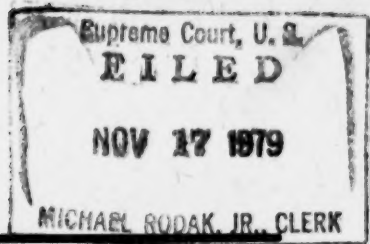


No. 79-463



In the Supreme Court of the United States

OCTOBER TERM, 1979

**CITY OF BETHEL, ALASKA AND COMMUNITY
LIQUOR SALES, INC., PETITIONERS**

v.

UNITED STATES OF AMERICA

***ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE NINTH CIRCUIT***

**MEMORANDUM FOR THE UNITED STATES
IN OPPOSITION**

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530

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**MEMORANDUM FOR THE UNITED STATES
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Petitioners seek review of the decision below holding that income derived by Community Liquor Sales, Inc., a nonprofit Alaskan corporation, from the retail sale of liquor is not exempt from federal income tax under Section 115(a) of the Internal Revenue Code of 1954 (26 U.S.C. (1970 ed.)) or the Constitution.

The pertinent facts are undisputed and may be summarized as follows: In 1966, the citizens of Bethel, Alaska, voted to end two years of prohibition and to allow the controlled sale of alcoholic beverages in the community (Tr. 54).¹ In order to permit the city to

¹"Tr." refers to the trial transcript of the trial; "Ex." refers to exhibits introduced in the district court; and "R." refers to the three-volume clerk's record filed in the court of appeals.

maintain the sale of alcohol and to insure that it would share in revenue generated by the sales, three citizens of Bethel incorporated petitioner Community Liquor Sales, Inc., as a nonprofit corporation on December 5, 1966 (Tr. 14, 72; Pltf. Ex. 2). The corporation was managed by a board of three trustees appointed by the Bethel City Council. Upon dissolution, the corporate assets were to be distributed to the City of Bethel (Pltf. Exs. 2, 3).

The Alaskan Alcoholic Beverages Control Board at first declined to issue Bethel a liquor license, based on an opinion from the Attorney General of Alaska that Bethel did not have the statutory authority to hold a liquor license or to operate a liquor store either directly or indirectly through a corporation under its control (R. 120). However, upon a representation by the City Attorney of Bethel that the City did not intend to operate the retail liquor store itself, the Attorney General modified his earlier opinion and ruled that it would be proper to issue a license to Bethel for immediate disposition to an independent corporation (R. 121). The license was then issued (Tr. 21-22).

From 1967-1973, petitioner Community Liquor Sales operated Bethel's only retail liquor outlet. It filed federal income tax returns for 1969-1971. It now seeks a refund of all taxes paid during those years asserting that it was exempt from taxation as an agency of the City of Bethel (Pltf. Ex. 16; R. 48, 49). In this refund suit brought by petitioners in the United States District Court for the District of Alaska, the district court ruled that although petitioner Community Liquor Sales was not constitutionally immune from federal taxation, its income was exempt from income taxes under Section 115(a)(1) of the Code. That provision excludes from gross income "income derived from * * * the exercise of any essential

governmental function and accruing to a State or Territory, or any political subdivision thereof * * *." The court of appeals reversed. It held that Community Liquor Sales' income was not exempt under Section 115(a)(1) because it did not "accrue" to the City of Bethel within the meaning of the statute (Pet. App. A).

1. The decision below correctly held that Community Liquor Sales' income did not "accrue" to the City of Bethel as that term is used in Section 115(a)(1), because the City had no claim or right to that income other than the general right which existed by virtue of its control of the corporation. *Omaha Public Power District v. O'Malley*, 232 F.2d 805 (8th Cir.), cert. denied, 352 U.S. 837 (1956); *Bear Gulch Water Co. v. Commissioner*, 116 F.2d 975 (9th Cir.), cert. denied, 314 U.S. 652 (1941); *Troy State University v. Commissioner*, 62 T.C. 493 (1974); S. Rep. No. 80, 63d Cong., 1st Sess. 26 (1913). Community Liquor Sales had never declared any dividends (Tr. 62), and, other than an unspecified number of payments to the city's creditors, the corporation made no distributions to or on behalf of the city (Tr. 61).² Its income therefore did not "accrue" to the City of Bethel.

2. Contrary to petitioners' assertion (Pet. 7), the court of appeals did not purport to create a new definition of "accruing" for purposes of Section 115(a)(1). It simply determined that there was no objective evidence in the

²At the behest of the Bethel City Council, Community Liquor Sales made small contributions to various charities and community projects. However, those distributions were made directly to the recipients, and were not distributed first to the city (Tr. 153-154). To the contrary, Community Liquor Sales retained the bulk of its income for future purchases of inventory and possible expansion of its business (Tr. 142-144).

record to support Community Liquor Sales' claim that its income "accrued" to the City of Bethel under any reasonable definition of the term (Pet. App. A 15).³

Finally, as the court of appeals noted (Pet. App. A 14-15), the record does not support the conclusion that Community Liquor Sales was merely the City of Bethel's "alter ego." See *Omaha Public Power District v. O'Malley*, *supra*, 232 F.2d at 810; *Bear Gulch Water Co. v. Commissioner*, *supra*, 116 F.2d at 977. It was created as a separate and distinct legal entity to hold a liquor license and to operate a business which the City of Bethel, or a mere alter ego, would have been unable to do under state law. The corporation maintained its own accounts (Tr. 131) and it did not obtain any significant financing from the city (compare *Jamestown & Newport Ferry Co. v. Commissioner*, 41 F.2d 920 (1st Cir. 1930)). Finally, the income derived from its operations was not subject to any prearranged plan of distribution for the city's benefit (compare *Keokuk & Hamilton Bridge, Inc. v. Commissioner*, 180 F.2d 58 (8th Cir. 1950); *Decatur Water Supply Co. v. Commissioner*, 88 F.2d 341 (7th Cir. 1937)). In these circumstances, the decision below

³Although the court of appeals found it unnecessary to address the issue in view of its ruling that Community Liquor Sales' income did not "accrue" to the city, it is clear that the corporation's income (Pet. App. A 13, n. 2) was not derived from an exercise of an "essential governmental function" within the meaning of the statute. The operation of a commercial liquor store is not by nature a governmental function, notwithstanding the philanthropic objectives of the state. Cf. *Ohio v. Helvering*, 292 U.S. 360 (1934); *South Carolina v. United States*, 199 U.S. 437 (1905).

properly concluded that the corporation's income did not "accrue" to the City of Bethel so as to be exempt under Section 115(a)(1).⁴

3. *Omaha Public Power District v. O'Malley*, *supra*; *Decatur Water Supply Co. v. Commissioner*, *supra*; or *Jamestown & Newport Ferry Co. v. Commissioner*, *supra*, upon which petitioners rely (Pet. 7), do not conflict with the decision below. Indeed, *Omaha Public Power District* fully supports the decision in this case. There, the Commissioner sought to tax the income of a corporation organized by Nebraska citizens to own and operate a public utility solely for the benefit of the Omaha District, a political subdivision of the State of Nebraska. The court held that the corporation's income was taxable because the Omaha District did not acquire any "vested rights" or "enforceable claim" to the income merely on account of its beneficial ownership of the corporate stock. Moreover, there were no facts that would have justified disregarding the status of the corporation as a separate taxable entity.

The other two cases are factually distinguishable. *Jamestown & Newport Ferry Co.* held that the income of a corporation providing ferry services to the insular community that owned a majority of its stock was exempt under the predecessor of Section 115(a)(1) because the corporation was the functional equivalent of a municipal enterprise and taxes were the "sole financial basis of its operations" (*id.* at 923). Finally, *Decatur Water Supply*

⁴Petitioners suggest (Pet. 7) that the court of appeals should have applied the clearly erroneous standard in its review of the district court's determination. But that standard of appellate review is applicable to factual determinations. See *Commission v. Duberstein*, 363 U.S. 278 (1960). Here, the essential facts are not disputed. The question whether those undisputed facts established that the income in question "accrued" to the City of Bethel is a question of law.

Co. did not involve a claim for exemption under Section 115(a)(1) or a statutory predecessor. There, the court ruled that water revenues collected by the city and deposited in a joint account with a corporation organized by the citizens of Decatur, Illinois, to purchase land to be used in the construction of a city water reservoir were not the corporation's "gross income" because it was merely an "instrumentality" of the city. The corporation had no beneficial interest in the water revenues but was obligated by contract to use them solely to pay dividends and to retire its outstanding stock (*id.* at 345).

4. Finally, petitioners argue (Pet. 8-9) that the Tenth Amendment immunizes Community Liquor Sales from the federal income tax. It is, however, well settled that Congress may constitutionally tax the revenues the state derives from such commercial activity. *Ohio v. Helvering*, 292 U.S. 360, 369 (1934); *South Carolina v. United States*, 199 U.S. 437, 453-454 (1905).

It is therefore submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

NOVEMBER 1979